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CASE NOTES

ANTITRUST: MONOPOLIZATION AND ATTEMPT TO MONOPOLIZE — REASONABLE CONDUCT FOR ONE WITH MONOPOLY POWER INCLUDES UTILIZATION OF MARKETING PRACTICES EMPLOYED BY OTHER COMPETITORS IN MARKET — *California Computer Products, Inc. v. International Business Machines Corp.*, 613 F.2d 727 (9th Cir. 1979).

Though none have yet succeeded, many companies have tried to obtain a final judgment against International Business Machines (IBM) for monopolizing or attempting to monopolize the computer industry.¹ The constantly evolving technology of the computer industry has made litigation of such claims particularly difficult. IBM and other general purpose computer system manufacturers are now marketing fourth generation computers, in an industry just thirty years old. This rapid growth has left courts divided on the threshold issue of defining a relevant product market.² Uncertainty as to the state of the law necessarily imposes hardships on plaintiffs

• 1981 by Manuel Fishman

1. See *In re IBM Peripheral EDP Devices Antitrust Litigation*, 481 F. Supp. 965 (N.D. Cal. 1979) (judgment for defendant); *ILC Peripherals Leasing Corp. v. IBM*, 458 F. Supp. 423 (N.D. Cal. 1978) (directed verdict for defendant); *Telex Corp. v. IBM*, 367 F. Supp. 258 (N.D. Okla. 1973), *rev'd in part*, 510 F.2d 894 (10th Cir. 1975), *cert. dismissed*, 423 U.S. 802 (1975); *Greyhound Computer Corp. v. IBM*, No. 72-2553 (D. Ariz. July 12, 1972), *rev'd and remanded*, 559 F.2d 488 (9th Cir. 1977), *cert. denied*, 434 U.S. 1040 (1977); *MDC Data Centers, Inc. v. IBM*, 342 F. Supp. 502 (E.D. Pa. 1972) (summary judgment for defendant); *Control Data Corp. v. IBM*, 306 F. Supp. 839 (D. Minn. 1969) (settled out of court).

2. Compare *California Computer Products, Inc. v. IBM*, 613 F.2d 727 (9th Cir. 1979) (wherein the court assumes that an IBM plug-compatible disc drive and associated controllers constitute a separate sub-market) with *Telex Corp. v. IBM*, 510 F.2d 894 (10th Cir.), *cert. dismissed*, 423 U.S. 802 (1975) (holding that the relevant market should also include non-IBM plug-compatible peripheral products). The court in *ILC Peripherals Leasing Corp. v. IBM*, 458 F. Supp. 423 (N.D. Cal. 1978), found even that too narrow, holding that the plaintiff had failed to meet its burden of proof of establishing a relevant market because it had excluded alternative storage media (*i.e.*, tape and memory). Finally, in *In re IBM Peripheral EDP Devices Antitrust Litigation*, 481 F. Supp. 965 (N.D. Cal. 1979), the court rejected plaintiff's proof of relevant market because it excluded mini and micro computers as well as software supplies.

who seek to prohibit illegal restraints of trade. This volatility is harmful, and threatens to frustrate the fundamental objective of the Sherman Antitrust Act.³ A recent case, *California Computer Products, Inc. v. IBM*,⁴ indicates the Ninth Circuit still has not settled basic questions in this area of the law.

California Computer Products, Inc. (CalComp), of Anaheim, California, was established in 1958. The company is a subsidiary of Sanders Associates, Inc. of New Hampshire.⁵ Originally only a manufacturer of computer plotting devices, the company acquired Century Data Systems in 1969 and entered the disc drive market, manufacturing disc drives and controllers that were "plug compatible" with IBM computer mainframes.⁶

In October 1973, CalComp filed suit against IBM alleging that various IBM products and marketing practices prevented it from effectively competing in disc product sales and thus violated sections 1 and 2 of the Sherman Act.⁷ CalComp

3. 15 U.S.C. §§ 1-7 (1976). The fundamental objective of the Act is "the detection and frustration of all efforts unduly to restrain the free course of interstate commerce." *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 360 (1932).

4. 613 F.2d 727 (9th Cir. 1979).

5. AMERICAN ELECTRONICS ASS'N, AMERICAN ELECTRONICS ASS'N DIRECTORY 45 (32d ed. 1980).

6. 613 F.2d at 731. While an in-depth review of computer technology is beyond the scope of this Note, a basic computer system contains three distinct elements; a central processing unit (CPU), peripheral devices, and a controller. The CPU completes the large majority of data processing work for the system. It is referred to as the mainframe. Peripheral devices are attached to the CPU and either input information necessary for the CPU to perform its data processing work or output the data processing on to a printer, plotting device, video terminal, etc. A disc drive is an input peripheral device through which a computer program is fed into the CPU. The controller unit is the interface between the peripheral and the CPU. In addition to actually connecting the two elements, it performs initial data processing so as to facilitate the work for the CPU. See *Telex Corp. v. IBM*, 367 F. Supp. 258 (N.D. Okla. 1973), *rev'd in part*, 510 F.2d 894 (10th Cir. 1975).

This litigation concerns peripheral equipment — disc drives — which are plug compatible with IBM CPU's. In other words, IBM plug compatible manufacturers (PCM's) build disc drives comparable to IBM disc drives and copy the necessary interface so that any user can plug their disc drive into an IBM CPU.

7. 15 U.S.C. § 1 (1976) provides:

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars or by imprisonment not exceeding three years, or by both said punishments,

claimed injury to three classes of IBM competitors: 1) general purpose computer systems manufacturers, 2) leasing companies, and 3) IBM-compatible peripheral equipment manufacturers. Following three years of discovery and a jury trial lasting fifty-four days in the U.S. District Court for the Central District of California, IBM was granted a directed verdict.⁸ The district court held as a matter of law that plaintiff's evidence was insufficient to create an issue of fact for the jury. The Ninth Circuit Court of Appeals affirmed, limiting its inquiry to the sufficiency of CalComp's evidence, which the court reasoned required a showing of "substantial evidence."⁹

The court of appeals began its inquiry with CalComp's standing as a proper party in an antitrust action. The court ruled CalComp must show both injury causally linked to an illegal presence in the market and injury of the type the antitrust laws were intended to prevent.¹⁰ To satisfy the first element of the test, the court required "direct causal injury,"¹¹ reasoning that even though antitrust violations create many "foreseeable ripples of injury" the law does not allow all those affected to sue for damages.¹² To fulfill the second part of the

in the discretion of the court.

15 U.S.C. § 2 (1976) provides:

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

8. 613 F.2d at 731.

9. *Id.* at 733-34. The court applied, as its standard of review, the test enunciated in *Continental Co. v. Union Carbide*, 370 U.S. 690, 696 n.6 (1961): "[T]he appellate court must consider the evidence in its strongest light in favor of the party against whom the motion for directed verdict was made, and must give him the advantage of every fair and reasonable intendment that the evidence can justify. . . . The same rule governs in ruling on motions for directed verdict in treble damage suits under the antitrust laws." See also *Chisholm Bros. Farm Equip. Co. v. Int'l Harvester Co.*, 498 F.2d 1137 (9th Cir.), *cert. denied*, 419 U.S. 1023 (1974) wherein the court discusses the issue of "substantial evidence," noting "substantial evidence is more than a mere scintilla."

10. 613 F.2d at 732 (citing *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977)).

11. *Id.*

12. *John Lenore & Co. v. Olympia Brewing Co.*, 550 F.2d 495, 499 (9th Cir. 1977) (indirect ripple effect insufficient to allow claim for damages). The *John Lenore* holding has been followed in other circuits; see *Engine Specialties, Inc. v. Bombardier*

test, the court required a showing that the injury was caused by a reduction, rather than an increase, in competition. The court reasoned that the antitrust laws were enacted for the protection of competition, not competitors.¹³ The court ruled that CalComp lacked standing to maintain an antitrust action as to the first two categories of claims. CalComp was not among these two classes of IBM competitors, nor was there a direct causal injury that would grant it standing. The court proceeded to review CalComp's claim as to IBM's alleged anticompetitive effects on IBM-compatible peripheral equipment manufacturers.

The court outlined the *prima facie* case for section 2 monopolization. This three part test requires: 1) proof of defendant's possession of monopoly power in a relevant market; 2) willful acquisition or maintenance of that power; and 3) causal antitrust injury. The court conceded that CalComp had presented sufficient evidence to go to the jury on the issue of defendant's monopoly power in a relevant market. Monopoly power is the power to control prices or exclude competition in a relevant market¹⁴ and the existence of such power can be inferred from predominant market share.¹⁵ Whereas prior courts, forced to wrestle with the issue of monopolization of the computer industry, dissected the industry into distinct "sub-markets," in this case, the issue received short shrift. The court refused to examine the market evidence; rather, it noted that the evidence concerning various market definitions was in conflict and internally inconsistent. "Still, we assume *arguendo* that [plug-compatible disc drives] is an appropriately defined market."¹⁶ The court also minimized the issue of inferring monopoly power from a showing of predominant market share. Consequently, it refused to "become enmeshed in the . . . conflicting and complex evidence on this element" and assumed that IBM possessed monopoly power.¹⁷ The analysis of this issue is markedly different from the analysis in

Ltd., 605 F.2d 1 (1st Cir. 1979); *Midwest Paper Products Co. v. Continental Group*, 596 F.2d 573 (3d Cir. 1979); *Lupia v. Stella D'oro Biscuit Co.*, 586 F.2d 1163 (7th Cir. 1978), *cert. denied*, 440 U.S. 982 (1979).

13. 613 F.2d at 732 (citing *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962)).

14. *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 391 (1956).

15. *United States v. Grinnell Corp.*, 384 U.S. 563, 571 (1966).

16. 613 F.2d at 738.

17. *Id.* at 739.

prior cases¹⁸ where district and circuit courts cited *Pacific Coast Agricultural Export Association v. Sunkist Growers, Inc.*¹⁹ for the proposition that although market share is an important factor, it alone does not determine the presence of monopoly power.

The two remaining issues were whether there was sufficient evidence on IBM's alleged monopolizing conduct and whether plaintiff had sustained causal antitrust injury. The court reviewed IBM's contested marketing practices. In 1970 the company had introduced two disc drive products, the 2319A and the 2319B. Both were reworked versions of earlier disc drives, modified to facilitate interface with high speed CPU's.²⁰ In introducing these products IBM cut its prices on the disc drives by thirty percent. One year later IBM indirectly cut its prices in another way through its introduction of a long-term lease plan — the Fixed Term Plan (FTP) — covering most peripheral equipment. Disc drive prices were discounted eight percent and sixteen percent, on one and two year leases. Purchase prices on FTP products were also cut by fifteen percent.²¹

The court reasoned that IBM had merely responded to its competitors' lower prices by reducing its own prices to a point, well above the product's marginal cost,²² that was still

18. *E.g.*, *ILC Peripherals Leasing Corp. v. IBM*, 458 F. Supp. 423 (N.D. Cal. 1978) (granting a directed verdict for defendant and holding that regardless of IBM's market share, evidence indicated defendant lacked power to control prices and exclude competition in a market with a high degree of product innovation and minimal entry barriers for potential competitors); *Greyhound Computer Corp. v. IBM*, 559 F.2d 488 (9th Cir.), *cert. denied*, 434 U.S. 1040 (1977) (judgment for defendant reversed, the court holding that evidence other than IBM's predominant share of the market supported an inference of market dominance; the court cites IBM's market leverage due to initial concentration of IBM installed computer systems, high customer changeover costs, and superior price management capability).

19. 526 F.2d 1196 (9th Cir. 1975), *cert. denied*, 425 U.S. 959 (1976).

20. *See* note 5 *supra*.

21. 613 F.2d at 740-41.

22. *Id.* at 742. Discussion of economics is inevitable when cost is concerned. A company has two types of costs: "fixed" and "variable." Examples of fixed costs include management costs, depreciation, and property taxes. Fixed costs do not vary with output. Even if a company produces only one product unit, fixed costs remain the same. Examples of variable costs include labor directly related to production, repair and maintenance, royalties, fuel, and utilities.

"Total cost" is the sum of a company's fixed and variable costs. "Marginal cost" is the increment to total cost that results from producing an additional unit of output. It is solely a function of variable costs. Understandably, marginal cost is lower when production is down and increases as production approaches plant capacity and

"substantially profitable" for IBM. Judge Choy termed IBM's conduct "pro-competitive,"²³ and felt that competition from peripheral equipment manufacturers (including CalComp) had provided the stimulus for IBM's price reductions. Since CalComp's claim for damages arose as a result of these IBM price reductions, the competitive process had not been restricted and CalComp, therefore, had sustained no compensable injury from conduct which "unnecessarily excluded" competition.²⁴

Thus, the court disposed of the monopolization charge; it then addressed the alleged violation of a section 2 attempt to monopolize. The court set forth the necessary elements to show an illegal attempt to monopolize: 1) a finding of specific intent to control prices or destroy competition; 2) predatory or anti-competitive conduct; 3) dangerous probability of success; and 4) causal antitrust injury.

The *CalComp* interpretation of the plaintiff's prima facie case for a section 2 attempt to monopolize is highly controversial. Considered separately, each element in the court's test is based on sound precedent. However, the Ninth Circuit has adopted a "short cut" method of inferring "dangerous probability" of actual monopolization from a specific intent to destroy competition. Since "ordinarily specific intent is difficult to prove,"²⁵ the court inferred the requisite intent from a showing of predatory conduct aimed at accomplishing the unlawful purpose. This inferential analysis permits limited inquiry into whether there is sufficient evidence of defendant's anticompetitive conduct.²⁶

This truncated test for attempt to monopolize, first enunciated in *Lessig v. Tidewater Oil Company*,²⁷ has been consistently followed in the Ninth Circuit. It has been criticized

more labor, fuel, and maintenance is needed.

A final term, "average cost" will be discussed in more detail later. Average cost is the total cost divided by output. See Areeda & Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 700 (1975).

23. 613 F.2d at 740.

24. See note 10 and accompanying text *supra*.

25. 613 F.2d at 737 (quoting *Hallmark Indus. v. Reynolds Metals Co.*, 489 F.2d 8, 12 (9th Cir. 1973), *cert. denied*, 417 U.S. 932 (1974)).

26. See *Janich Bros. v. American Distilling Co.*, 570 F.2d 848, 854 (9th Cir. 1977), *cert. denied*, 439 U.S. 829 (1978).

27. 327 F.2d 459 (9th Cir.), *cert. denied*, 377 U.S. 993 (1964).

both within the Ninth Circuit²⁸ and by a majority of the eleven circuit courts of appeals.²⁹ Based on a reading of the 1905 Supreme Court decision in *Swift & Co. v. United States*,³⁰ the Ninth Circuit interpreted the Supreme Court's reference to "dangerous probability" as being a "consequence" of specific intent.³¹ *CalComp* takes the "short cut" rule one step further. *Lessig* permitted an inference of dangerous probability and specific intent based on independent proof of a clear section 1 violation (price fixing).³² In *CalComp* there was no allegation of a section 1 violation. Thus, the *CalComp* application of the *Lessig* "short cut" rule broadens the potential scope of that test. Though the Ninth Circuit has acknowledged the "substantial criticism"³³ of the *Lessig* hold-

28. See *General Communication Eng'r, Inc. v. Motorola Communication and Elecs., Inc.*, 421 F. Supp. 274, 284-85 (N.D. Cal. 1976).

29. See *Spectrofuse Corp. v. Beckman Instruments, Inc.*, 575 F.2d 256, 276 (5th Cir. 1978): "Although some others disagree with us, [citing *Lessig*] it is the law of the Fifth Circuit — with which the majority of our sister circuits around the country agree — that definition of the relevant market is required in attempt cases as well as in monopolization cases." *Coleman Motor Co. v. Chrysler Corp.*, 525 F.2d 1338, 1348 (3d Cir. 1975): "An essential element of a section two attempt to monopolize violation is that the actor have a specific intent to monopolize the relevant market. Another essential element of the offense is that the actor have sufficient market power to come dangerously close to success." (citations omitted). *Merit Motors, Inc. v. Chrysler Corp.*, 417 F. Supp. 263, 270 (D.D.C. 1976): "Clearly, one can threaten to monopolize only that which is capable of being monopolized. Accordingly, contrary to plaintiff's contention, the relevant market is a basic issue in a case charging an attempt to monopolize." *Tire Sales Corp. v. Cities Service Oil Corp.*, 410 F. Supp. 1222, 1230-31 (N.D. Ill. 1976): "This rule [referring to *Lessig*] has had a shaky history in the Ninth Circuit and has been widely disapproved by other courts. The rule followed by most courts is that an attempt to monopolize requires the specific intent to obtain monopoly power in the relevant market and the dangerous probability of success." (citations omitted). *Varney v. Coleman Co.*, 385 F. Supp. 1337, 1343 (D.N.H. 1974): "I disagree with *Lessig*. Mr. Justice Holmes intended specific intent and dangerous probability to be separate elements." *Becker v. Safelight Glass Corp.*, 244 F. Supp. 625, 637 (D. Kan. 1965): "The Ninth Circuit in *Lessig* relied on a footnote in *United States v. E. I. Du Pont De Nemours & Co.* . . . for its statement that the relevant market is not in issue in an attempt to monopolize case. With all respect, we do not read *Du Pont* as justifying such a statement." See also *Acme Precision Prod., Inc. v. American Alloys Corp.*, 484 F.2d 1237 (8th Cir. 1973).

30. 196 U.S. 375 (1905).

31. 327 F.2d at 474 n.46.

32. This distinction was reemphasized in later opinions. See *Janich Bros. v. American Distilling Co.*, 570 F.2d 848 (9th Cir. 1977), cert. denied, 439 U.S. 829 (1978); *Knutson v. Daily Review, Inc.*, 548 F.2d 795 (9th Cir. 1976), cert. denied, 433 U.S. 910 (1977); *Hallmark Indus. v. Reynolds Metals Co.*, 489 F.2d 8 (9th Cir. 1973), cert. denied, 417 U.S. 932 (1974).

33. *Knutson v. Daily Review, Inc.*, 548 F.2d 795, 814 (9th Cir. 1976), cert. denied, 433 U.S. 910 (1977).

ing and "short cut" rule, the *CalComp* decision makes no attempt to retreat from *Lessig*. It is uncertain to what extent the Ninth Circuit will continue to press this issue in the face of the Supreme Court's implicit disapproval of this formulation.³⁴

The Sherman Act deals with the "competitive reality" of the marketplace.³⁵ Thus, the peculiarities of the relevant market and its competitors becomes extremely important. What is reasonable for one competitor in one market may be unreasonably restrictive if attempted by a monopolist in the same market or by another competitor in a different market. As a rule, conduct lawful for a monopolist is excluded as the basis for the offense of attempt to monopolize. It would be unfair to punish a competitor for engaging in conduct which a monopolist could practice with legal impunity. The impact of a defendant's conduct on the competitive process in the market is indicative of the reasonableness of the restraint.

Courts have eschewed too narrow an interpretation of conduct constituting "willful acquisition or maintenance" of monopoly power or "predatory, anti-competitive conduct" directed at accomplishing the unlawful purpose. In *CalComp*, the court measured these two factual questions against a single standard: whether defendant's acts, otherwise lawful, were *unreasonably* restrictive of competition. In upholding the same IBM marketing and pricing actions which are the subject of the *CalComp* litigation, the Tenth Circuit Court of Appeals in *Telex Corp. v. IBM*³⁶ took into consideration two additional factors — "whether or not the acts are ordinary business practices typical of those used in a competitive market, and secondly whether the acts constitute the use of monopoly power."³⁷ With this in mind, *CalComp*'s evidence was comparatively weak. *CalComp*'s chairman testified that IBM's decision to cut prices was not a "punitive reaction." In testimony he stated he would "call it a defense of market position."³⁸ The court held that IBM's purpose in offering lower

34. See *General Communication Eng'g, Inc. v. Motorola Communication and Elecs.*, 421 F. Supp. 279, 285 n.24 (N.D. Cal. 1976) (citing *Walker Process Equip., Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172 (1965)).

35. *Times Picayune v. United States*, 345 U.S. 594, 615 (1952).

36. 510 F.2d 894 (10th Cir.), cert. dismissed, 423 U.S. 802 (1975).

37. *Id.* at 925-26.

38. 613 F.2d at 739-40 n.17.

prices on its 2319A and 2319B products was to regain market share and abate the competitive inroads achieved by peripheral manufacturers, who were "flourishing" under the company's "high price umbrella."³⁹ In addition, there was no evidence that the lower priced 2319A and 2319B were not substantially profitable for IBM. The company anticipated profits of twenty and thirty percent, respectively, before taxes, on the two disc drive units at the lower prices.⁴⁰

The *CalComp* decision holds that IBM had the right, as a dominant force in the market, to respond to the lower prices of competitors by itself reducing prices, within the boundaries of reasonable price competition, to a level substantially profitable for the company. The court characterized IBM's actions as "a part of the very competitive process the Sherman Act was designed to promote."⁴¹ The holding follows that enunciated by the same court in 1978 in *ILC Peripherals Leasing Corp. v. IBM*.⁴² It directly contradicts the 1977 holding in *Greyhound Computer Corp. v. IBM*⁴³ in which the court observed that one with monopoly power was not free to engage in business practices of a kind an ordinary enterprise might utilize with impunity. As a dominant force in the market, IBM was precluded from employing any otherwise lawful practice that unnecessarily excluded competition from the relevant market.⁴⁴

The United States Supreme Court has excepted from illegal monopolizing conduct, actions which increase market share and lead to monopoly power over market price, when accomplished by means of "a superior product, business acumen, or historic accident."⁴⁵ The exception was first elucidated in *United States v. Aluminum Company of America*⁴⁶ where the Court stated that it was not the intent of the Sherman Act to condemn the results of superior skill, foresight, and industry. The Court considered this superior competitor "the passive beneficiary of a monopoly."⁴⁷ Recently, courts

39. *Id.* at 739.

40. *Id.* at 740 n.19.

41. *Id.* at 742.

42. 458 F. Supp. 423 (N.D. Cal. 1978).

43. 559 F.2d 488 (9th Cir.), *cert. denied*, 434 U.S. 1040 (1977).

44. *Id.* at 498.

45. *United States v. Grinell Corp.*, 384 U.S. 563, 571 (1966).

46. 148 F.2d 416 (2d Cir. 1945).

47. *Id.* at 430.

have taken a more activist view of the "thrust upon" monopolist. The *Telex* court dealt with the same issue and argued that a manufacturer who sees its market share eroded by others marketing copies of its product may use ordinary marketing practices to defend its market dominance. The court in *Telex* held: "[W]e do not accept the requirement that . . . the 'thrust upon' shorthand description means that the events or acts must be entirely involuntary."⁴⁸ Likewise, the *CalComp* decision takes the position that since IBM's growth was a consequence of a superior product it was entitled to maintain this position in the market through "business acumen," including "shrewdness in profitable price competition."⁴⁹ The court's analysis may lead to widespread price competition by those with monopoly power. Just how far the courts will go in permitting "shrewdness" is an open question.

CalComp does not represent the final word on the boundaries of "reasonable price competition." The Ninth Circuit has since retreated from the test adopted in *CalComp* that "price reductions up to the point of marginal cost are consistent with competition on the merits"⁵⁰ and that failure to show that defendant's prices are below marginal cost is a failure "as a matter of law."⁵¹ A district court case, *In re IBM Peripheral EDP Devices*,⁵² severely limited the marginal/average variable cost rule. The court held pricing below "average cost" created an inference of predation⁵³ and adopted the position that average cost is the point below which all competitors incur a loss.⁵⁴ While this presents the most recent definition of "predatory pricing," *CalComp* considerably advances the understanding of "reasonable" conduct for a monopolist, and thus any domi-

48. 510 F.2d at 927.

49. 613 F.2d at 742.

50. *Id.* at 743.

51. *Id.* at 742.

52. 481 F. Supp. 965 (N.D. Cal. 1979).

53. *Id.* at 995.

54. *Id.* at 992. This limited the marginal cost rule to fact settings involving non-monopolists charged with attempt to monopolize where no independent evidence of specific intent and dangerous probability of success is admitted. *Id.* at 989. *CalComp* was characterized as "limited to the facts of the case" and a "refinement" of the standard. *Id.* See *Utah Pie Co. v. Continental Baking*, 386 U.S. 685, 698 (1967) (The Supreme Court labelled defendant's price "below cost" for being "less than its direct cost plus an allocation for overhead"). Other courts have adopted the marginal/average variable cost rule. *O. Hommel Co. v. Ferro Corp.*, 472 F. Supp. 793 (W.D. Pa. 1979).

nant competitor. Both cases express the current position on section two monopolization and attempt to monopolize claims. Plaintiff's prima facie case for "predatory pricing" has been made easier. Any price below full average cost frustrates competition and is presumed "predatory." However, above this threshold a monopolist is free to raise or lower prices and engage in "shrewdness in profitable price competition." A monopolist who has acquired its position by "superior product, business acumen or historic accident" need no longer maintain a "passive" posture towards its competitors, but may engage in the same marketing techniques employed by other competitors in the industry as long as it maintains a price above "average cost." However, antitrust law, especially section one and section two violations, is still in a volatile period. As the *CalComp* case indicates, the Ninth Circuit has changed its direction on a number of issues and is still in a period of change, unable to guarantee a sure footing to any party.

Manuel Fishman

ANTITRUST—MANUFACTURERS ENGAGED IN A DUAL DISTRIBUTION SYSTEM ARE SINKING IN THE UNCLEAR WATER OF PER SE ILLEGALITY—*Guild Wineries and Distilleries v. J. Sosnick & Son*, 102 Cal. App. 3d 627, 162 Cal. Rptr. 87 (1980).

Guild Wineries and Distiller is a wine marketing cooperative, controlled by its member grape growers. At the time, Guild controlled approximately two percent of the Northern California wine market. Fourteen wholesalers distributed Guild's wines, each assigned to a sales area adjacent to the wholesaler's headquarters. The territories were not exclusive in practice; many of the distributors sold Guild products outside their assigned territories due to overlapping customers' accounts.

In 1975, Guild terminated the wholesale distributorship in the Fresno area. Because most of its growers were in Fresno, Guild decided to increase its sales in this area by engaging in its own wholesaling under the name "Valley Distributors" (Valley Distributors was wholly owned and controlled by Guild). The prior Fresno distributor's most lucrative account had been the Lucky Stores chain, whose central purchasing operations were located in San Leandro (Alameda County) and not in the Fresno area.

J. Sosnick, a wholesale food distributor who marketed Guild wine in San Mateo County, also sold kosher foods to Lucky. When the Fresno distributorship was terminated, Sosnick began to sell Guild wines to the Lucky chain. Guild asked Sosnick to discontinue selling Guild wine to Lucky because Guild needed the lucrative Lucky account to offset the expenses of operating its newly created "Valley Distributors." Sosnick refused. Two weeks later, Guild terminated Sosnick's wine distribution contract. Sosnick then failed to pay for wine Guild had delivered, and Guild sued for monies due. Sosnick cross-complained for alleged illegal imposition of territorial restrictions.¹

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1. CAL. BUS. & PROF. CODE § 16720 (West 1964) specifically prohibits the formation of a trust (i.e., a combination of capital, skill, or acts by two or more persons) for, among others the following purposes: "To create or carry out restrictions in trade or

At Guild's request the trial court gave instructions to the jury directing them to hold Guild liable only if they found that its termination of Sosnick's distributorship was the product of an agreement or conspiracy among competing independent wholesalers to divide the territory and customers between themselves.² The jury was precluded from finding liability if Guild had acted alone, even if it had cancelled Sosnick for his refusal to yield the Lucky account to Guild.³ Sosnick's proposed instructions, which the trial court declined to give, were based on the theory that Guild's conduct would violate antitrust laws if it were carried out to enforce an illegal customer allocation agreement.⁴ Judgment was entered from a

commerce To prevent competition in manufacturing, making, transportation, sale or purchase of merchandise, produce or any commodity."

2. The trial court gave Guild's instruction 37:

Under the facts of this case any restrictions and limitations on territories or on customers imposed by Guild on its distributors would not constitute a violation of the antitrust laws entitling Mr. Sosnick to recover unless the acts were taken by Guild not as a producer or manufacturer interested in the distribution of its product, but rather were taken to enforce an agreement or conspiracy among the competing independent wholesalers of its products to divide the territories and customers between themselves.

If you find that such an agreement existed, that is an agreement between the independent wholesalers to divide the market and to allocate the customers and that Guild, in terminating Sosnick, knowingly joined and acted as a party or acted in furtherance of that agreement, then you must find in favor of Sosnick and against Guild on this issue.

102 Cal. App. 3d at 633 n.1, 162 Cal. Rptr. at 90 n.1.

3. The court also gave Guild's instruction 36:

I instruct you that if Guild, provided it was acting alone and not pursuant to an unlawful conspiracy, asked Sosnick to cease dealing with Lucky Stores because it wanted to service Lucky Stores and then terminated Sosnick because he refused, an antitrust violation could not be established for that termination.

Id. at 633 n.1, 162 Cal. Rptr. at 90 n.2.

4. Sosnick's proposed instructions 17 and 19 stated:

A seller of goods has a legal right to announce to his customers that he has established a policy prohibiting such customers from reselling the goods to a specified person or persons, and to refuse to deal with any customer who does not follow the policy. But it is illegal for the seller to take affirmative action, such as threatening to stop selling to his customer, to enforce his policy. Furthermore, the law imposes two important limitations on this right:

First, if a seller announces to his customer a policy which—if accepted by the customer—would result in an illegal horizontal customer allocation agreement, it is illegal for the seller to go beyond a mere announcement of the policy and use other means—such as threats of terminations if the customer refuses to comply—which effect adherence to

jury verdict in favor of Guild. Sosnick appealed on grounds of prejudicial jury instructions.

Because California's Cartwright Act⁵ is patterned after the federal Sherman Antitrust Act,⁶ "federal cases interpreting the Sherman Act are applicable with respect to the Cartwright Act."⁷ The court of appeal, therefore, looked to federal authority in deciding whether there was a violation of anti-trust laws that would warrant Sosnick's proposed jury instructions. Under the court's analysis, the crucial issue was whether Guild's conduct imposed either vertical territorial restrictions⁸ on Sosnick judged under the "rule of reason"⁹ or a horizontal restraint of trade¹⁰ governed by the *per se*

the policy.

Second, it is illegal for the seller to refuse to deal with a customer, if the refusal is made pursuant to an illegal combination or conspiracy (Instruction 17).

If a supplier (such as Guild) having an ongoing business relationship with a distributor (such as Sosnick) requests the distributor to enter into an agreement which would violate the Cartwright Act; if the distributor refuses to enter into the proposed illegal agreement; if the supplier exerts pressure upon the distributor to accept the illegal agreement; and if the supplier terminates the distributor because of the distributor's refusal to accept, then the termination itself is in violation of the Cartwright Act (Instruction 19).

Id. at 633 n.3, 162 Cal. Rptr. at 90 n.3.

5. CAL. BUS. & PROF. CODE §§ 16700-16750 (West 1964 & Supp. 1980).

6. 15 U.S.C. §§ 1-7 (1976).

7. Chicago Title Ins. Co. v. Great Western Financial Corp., 69 Cal. 2d 305, 306, 70 Cal. Rptr. 849, 855, 444 P.2d 481, 487 (1968).

8. "Vertical territorial restrictions" are non-price restraints which a manufacturer imposes upon a non-integrated distributor in limiting the latter's resale territory or customers.

9. Under the "rule of reason" standard, the fact-finder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition. *Continental T.V. Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 49 (1977).

10. Horizontal restraints are agreements among firms, usually at the same stage of production. Thus, agreements among manufacturers, among wholesalers, or among retailers are horizontal.

In *Pitchford Scientific Instruments Corp. v. PEPI, Inc.*, 435 F. Supp. 685, 687 (W.D. Pa. 1977), the court again defined vertical and horizontal restraints:

Vertical restraints may be understood as those imposed by agreement between a manufacturer and a distributor or dealer, where the parties occupy a different rank in the hierarchy of distribution. Horizontal restrictions may be understood as those imposed by agreement between parties of the same rank or level in the system of distribution.

In *Oreck v. Whirlpool*, 579 F.2d 126 (2d Cir. 1978), the court distinguished the two restrictions:

Horizontal restraints alone have been characterized as "naked restraints

doctrine.¹¹

Federal judicial development in the non-price, territorial restriction facet of antitrust law has followed an unclear path. In *Standard Oil v. United States*¹² the United States Supreme Court declared the "rule of reason" to be the governing standard thereby limiting violations under section 1 of the Sherman Act to those covenants which *unreasonably* restrained trade. Because litigation following this holding proved to be extremely complex and lengthy, courts after *Standard Oil* applied the "*per se* illegality" doctrine to resolve disputes involving restraint of trade.¹³ The *per se* doctrine was not considered a departure from the "rule of reason" rather a refinement of that doctrine.¹⁴

Fifty-two years after the *Standard Oil* decision, the Supreme Court followed the *per se* doctrine to hold that "horizontal" covenants allocating territories within which competitors may operate are "tantamount to agreements not to compete, and hence inevitably violative of the Sherman Act."¹⁵ Ten years later, in *United States v. Arnold, Schwinn & Co.*, the Court first held "vertical" territorial restrictions to be *per se* illegal when coupled with price fixing.¹⁶

of trade with no purpose except stifling competition," and, therefore *per se* violations of the Sherman Act. On the other hand, while vertical restrictions may reduce intrabrand competition by limiting the number of sellers of a particular product, competing for a given group of buyers, they also promote interbrand competition by allowing the manufacturer to achieve certain efficiencies of distribution of its products. They are, therefore, to be examined under the *rule of reason*.

Id. at 131 (emphasis original)(citations omitted).

11. "Per se rules of illegality are appropriate only when they relate to conduct that is manifestly anticompetitive." *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 49-50 (1977). The Court in *Northern Pacific R. Co. v. United States*, 356 U.S. 1 (1958) set forth this concept:

[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.

Id. at 5.

12. 221 U.S. 1 (1911).

13. See, e.g., *Northern Pacific R. Co. v. United States*, 356 U.S. 1 (1958); *Fashion Originators Guild v. FTC*, 312 U.S. 457 (1940); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1939); *United States v. Trenton Potteries*, 273 U.S. 392 (1927).

14. *Comanor, Vertical Territorial and Customer Restrictions: White Motor and its Aftermath*, 81 HARV. L. REV. 1419, 1420 (1968).

15. *White Motor Co. v. United States*, 372 U.S. 253, 267 (1963).

16. 388 U.S. 365, 366 (1967).

The *per se* holding of *Schwinn* was reversed a decade later in *Continental T.V., Inc. v. GTE Sylvania, Inc.*¹⁷ The *Sylvania* Court, in overruling *Schwinn*, announced that a "rule of reason" standard should apply to vertical restrictions since they promote economic efficiency.¹⁸ Justice Powell, writing the majority opinion, explained that vertical restrictions can "promote inter-brand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products"¹⁹ and declared that inter-brand competition²⁰ rather than intra-brand competition,²¹ "is the primary concern of antitrust law."²² However, in stressing the Sherman Act's focus on inter-brand competition, the *Sylvania* Court did not go so far as to condone "horizontal" intra-brand restraints.

The majority in *Guild* implicitly utilized the *per se* principles (horizontal restraints of trade) outlined in *Schwinn* and reversed the trial court on grounds that the jury instructions were inconsistent with the *per se* doctrine. Had the *Sylvania* and *Standard Oil* "rule of reason" approach to vertical restraints of trade been applied, the trial court's instructions would have been either correct or harmless error. The evidence presented would not have supported antitrust liability under this latter theory.

Guild Wineries was originally involved in an exclusively

17. 433 U.S. 36 (1977).

18. *Id.* at 54-58. Economic analysis has substantiated Justice Powell's majority opinion: Vertical territorial restrictions can create inter-brand competition through distribution efficiencies without resulting in monopoly losses. See Baker, *Vertical Restraints in Times of Change: From White to Schwinn to Where?*, 44 ANTITRUST L.J. 537 (1975); Kellman, *Vertical Territorial Restrictions and the Limits of Planning*, 46 ANTITRUST L.J. 1107 (1978); Posner, *Exclusionary Practices and the Antitrust Laws*, 41 U. CHI. L. REV. 506 (1974). But these distribution efficiencies are only accomplished at the expense of preventing distributors from competing with one another for the same customers, thus mitigating intra-brand competition. Kellman, *supra*, at 1118-19; Comanor, *supra*, note 14, at 1422.

19. 433 U.S. at 54.

20. Inter-brand competition involves the market share of one type of product. Each manufacturer introduces his own respective brand of the particular type of product and all manufacturers compete against each other in trying to capture a larger share of that product's market.

21. Intra-brand competition involves the demand for one particular brand of a product. The distributors then compete among themselves for the retail market share of that particular brand, e.g., Guild wines. This is opposed to the competition among inter-brand manufacturers, e.g., the California wine market.

22. 433 U.S. at 52 n.19.

vertical relationship with each of its independent distributors. After creating its own "Valley Distributors", Guild also became involved in a horizontal relationship with the independent distributors. When a manufacturer also distributes its own products, (dual distribution), there is a departure from conventional vertical and horizontal relationships. The manufacturer, in imposing both vertical and horizontal restraints, affects its own distributorship market as well as those of the independent distributors of its products. The manufacturer's vertical goal of efficiency of distribution is in competition with the distributors' horizontal goal of maximizing the number of goods sold in each respective territory.

The *Guild* court concluded that the vertical relationship Guild had with its independent wine distributors was severed when Guild itself became a distributor. It considered Guild's subsequent territorial restrictions to be coercion of a fellow distributor (Sosnick) into allocating customers. The court then said this coercion was, in effect, an agreement to divide territories among the distributors (a "horizontal" restraint of trade) and thus a *per se* violation of the Cartwright Act.

The *Guild* majority relied on *American Motor Inns, Inc. v. Holiday Inns, Inc.*,²³ a dual distribution fact situation in which Holiday Inns was operating as franchisor of its trademark and as an operator of inns. In *Holiday Inns*, the court found that restraints in the Holiday Inn franchise agreements, which prohibited franchisees from establishing competing Holiday Inns or noncompeting Holiday Inns in cities where Holiday Inns, Inc. operated as an establishment, constituted a market allocation agreement among competitors and was *per se* illegal.

The majority opinion in *Guild* also referred to a recent application of the *per se* principle to a dual distribution system in *Krehl v. Baskin-Robbins Ice Cream Co. (BRICCO)*,²⁴ where BRICCO was integrated in both the manufacturing and supply of Baskin-Robbins ice cream products through its subsidiary Baskin-Robbins Ice Cream, Inc. In *Krehl*, the court held that the franchisor (BRICCO) was "[a]n entity occupying such a dual role [and] is forbidden *per se* from imposing terri-

23. 521 F.2d 1230 (3d Cir. 1975).

24. 78 F.R.D. 108 (C.D. Cal. 1978).

torial market restrictions.”²⁵

The *Guild* majority, in relying on *Holiday Inns*, *Krehl*, and others,²⁶ clearly distinguished the dual distribution system as an exercise in horizontal restraint of trade. Yet the court said that labeling a restraint “vertical” or “horizontal” to resolve disputes involving a dual distribution system deteriorates into “formalistic line drawing,”²⁷ and declared the primary consideration to be whether the conduct produces only anticompetitive effects without “countervailing benefits.”²⁸

Guild argued that economic efficiencies necessitated the decision to terminate Sosnick; the action was taken in order to afford Valley Distributors the exclusive selling rights to the Lucky chain. However, the majority concluded that the “countervailing benefits” of promoting Guild’s inter-brand competition in the California wine market through economic efficiencies were not substantial enough to disregard the anti-competitive effects of these territorial restrictions on intra-brand competition among Guild’s distributors. The majority then applied the *per se* principle to these particular restrictions and concluded that Guild’s conduct had no clearly discernible benefits to competition; it was therefore *per se* illegal.

Justice Christian, in dissent, recognized the difficulty of analyzing the dual distribution system when attempts are made to distinguish restrictions (or restraints) solely as horizontal or vertical. Justice Christian, like the majority, reiterated *Sylvania*’s condemnation of “formalistic line drawing,” and utilized this theme to summarily dispose of any attempt to “pigeonhole” restrictive conduct into such categories.

The dissent limited the *per se* doctrine only to those situations which involve clearly horizontal restraints originating in agreements among retailers. When the challenged restrictions are not exclusively horizontal, and no evidence exists to indicate an agreement originating among the retailers, then *per se* principles would be inapplicable. In following the *Sylvania* Court’s holding that adverse effects on non-price distribution restrictions on intra-brand competition are outweighed

25. *Id.* at 123.

26. See *Hobart Brothers Co. v. Malcolm T. Gilliland, Inc.*, 471 F.2d 894 (5th Cir. 1973); *United States v. Topco Associates*, 405 U.S. 596 (1972).

27. 102 Cal. App. 3d at 635, 162 Cal. Rptr. at 92 (citing *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. at 58-59).

28. *Id.*

by the potential for beneficial effects on inter-brand competition, the dissent concluded that the "rule of reason" must be applicable in determining the illegality of Guild's conduct.²⁹

The dissent in *Guild* thus completed the majority's disguised economic analysis of the anticompetitive effects of Guild's attempted restrictions on Sosnick. It stated that the probability and severity of anticompetitive consequences resulting from a particular practice must be balanced against the procompetitive consequences of such conduct. This can only be accomplished when the conduct is judged under the "rule of reason."

The *Guild* majority, by declaring the restraint to be *per se* illegal without balancing the competitive effects, has imposed a twofold choice on manufacturers: 1) to deal exclusively outside the dual distribution system (when considering economies of distribution) in order to avoid antitrust litigation; or, 2) to accede to "free rides"³⁰ and an inefficient or discretionary supply of promotional services (for the manufacturers' product) by the distributors.

Sylvania initiated considerations of economic efficiency. In a situation such as *Guild*, where the manufacturer owns a mere two percent of the market, economic efficiency would necessitate territorial restrictions on the distributors. Because there was no conspiracy among Valley and the independent distributors, restraint of competition did not appear to be Guild's primary motive. Instead, Guild wished to curtail intra-brand competition to increase its own share of the extensive California wine market and, in effect, promote inter-brand competition.

Since "*per se* rules of illegality are appropriate only when they relate to conduct that is manifestly anti-competitive,"³¹ *Sylvania* would seem to require a consideration of Guild's economic necessity for terminating Sosnick. Justice Christian's strong dissent supports this demand for inquiry when he

29. *Id.* at 646 (Christian J., dissenting).

30. Overlapping accounts are created when the distributor sells more than just the manufacturer's product. In this situation the distributor may have accounts for other types of goods outside their manufacturer-assigned territory and, in the process of distributing those other goods, they sell the manufacturer's product to the customer. The distributor thus obtains a "free ride" into another manufacturer-assigned territory by realizing revenue from these accounts without expending cost for promotion.

31. 433 U.S. at 49-50.

states that the restrictions should be reviewed under the *Sylvania* "rule of reason" approach.³²

The restrictions involved in *Guild* are not "purely" horizontal, did not originate from the distributor's hierarchical level, and did not force Sosnick to lose any pre-restraint customer accounts. The majority in *Guild* should have interpreted Guild's actions as intra-brand restraint caused by economic necessity and business judgment and, therefore, applied the more appropriate and prevailing "rule of reason" standard.

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32. 102 Cal.App.3d at 646 (Christian, J., dissenting).

WORKERS' COMPENSATION—EMPLOYEE MAY MAINTAIN AN ACTION AT LAW AGAINST EMPLOYER FOR AGGRAVATION OF INDUSTRIAL DISEASE CAUSED BY EMPLOYER'S FRAUDULENT CONDUCT—*Johns-Manville Products Corp. v. Superior Court*, 27 Cal. 3d 465, 612 P.2d 948, 165 Cal. Rptr. 858 (1980).

In 1946, the Johns-Manville Products Corporation, a manufacturer of asbestos, hired Reba Rudkin to work at its Pittsburg, California plant.¹ The company had known since 1924 that prolonged exposure to or ingestion of asbestos posed health dangers, but advised Rudkin that working with asbestos was safe.² Rudkin himself, ignorant of any risk, remained employed with Johns-Manville for twenty-nine years. During that time and due to continuous exposure to asbestos at the plant, Rudkin developed pulmonary disease.³

Johns-Manville retained doctors to examine Rudkin, but failed to inform these doctors of the danger of exposure to asbestos, of the development of Rudkin's pulmonary disease, or of the disease's relationship to Rudkin's extensive contact with asbestos on the job. The company further concealed the fact that Rudkin's illness was work-related by failing to file a First Report of Occupational Injury or Illness with the State of California as required by law.⁴

To recover for his disability, Rudkin filed a complaint against his employer seeking compensatory and punitive damages.⁵ The complaint alleged that Johns-Manville fraudulently induced Rudkin to continue employment that he would have terminated had he known that his illness had been caused by working conditions at the plant. Johns-Manville contended that the action was barred by California Labor Code section 3601,⁶ which provides that workers' compensation benefits are

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1. *Johns-Manville Products Corp. v. Superior Court*, 27 Cal. 3d 465, 469, 612 P.2d 948, 950, 165 Cal. Rptr. 858, 860 (1980).

2. *Id.* at 469, 612 P.2d at 950, 165 Cal. Rptr. at 860.

3. *Id.*

4. *Id.*

5. *Id.* at 470, 612 P.2d at 951, 165 Cal. Rptr. at 861.

6. CAL. LAB. CODE § 3601(a) (West Supp. 1980) provides in part: "Where the conditions of compensation exist, the right to recover such compensation . . . is . . .

the exclusive remedy of an employee injured while acting within the scope of his employment. The company then moved for judgment on the pleadings, which motion was denied.

Johns-Manville then petitioned the California Supreme Court for a writ of mandate to set aside the trial court's order. Justice Mosk, joined by Chief Justice Bird and Justices Tobriner, Manuel and Newman, concluded that the writ should be denied.⁷ The court held that although the workers' compensation law bars an employee action at law for initial injury, a cause of action may exist for an aggravation of that injury caused by the employer's fraudulent concealment of the condition and its cause.⁸

The court found the dispute in this case centered upon whether California Labor Code section 4553,⁹ which awards a one-half increase in compensation benefits to the employee injured by the employer's serious and willful misconduct, was intended by the Legislature to cover the intentional acts of employers that cause employee injury. If section 4553 applied to the misconduct of Johns-Manville, then that increase in compensation benefits would be Rudkin's exclusive remedy, and an action at law would be barred.

The court first determined that section 4553 was intended by the Legislature to replace a common law right of action.¹⁰ Citing *Mercer-Fraser Co. v. Industrial Accident Commission*,¹¹ the court further found that the "serious and willful misconduct" in section 4553 was identical to the "intentional misconduct" alleged in Rudkin's complaint.¹² Ac-

the exclusive remedy for injury or death of an employee against the employer or against any other employee of the employer acting within the scope of his employment."

7. 27 Cal. 3d at 478-79, 612 P.2d at 956, 165 Cal. Rptr. at 866. After the petition was filed Rudkin died of lung cancer. The court proceeded to determine the issue, noting that by virtue of California Probate Code § 573 an action for personal injuries survives the death of the plaintiff. *Id.* at 470, 612 P.2d at 951, 165 Cal. Rptr. at 861.

8. *Id.* at 469, 612 P.2d at 950, 165 Cal. Rptr. at 860.

9. CAL. LAB. CODE § 4553 (West Supp. 1980) reads in part: "The amount of compensation otherwise recoverable shall be increased one-half where the employee is injured by the serious and wilful misconduct of . . . the employer, or . . . [i]f the employer is a corporation, on the part of an executive, managing officer, or general superintendent thereof."

10. 27 Cal. 3d at 472, 612 P.2d at 952, 165 Cal. Rptr. at 862.

11. 40 Cal. 2d 102, 251 P.2d 955 (1953).

12. 27 Cal. 3d at 472-73, 612 P.2d at 952-53, 165 Cal. Rptr. at 862-63.

cordingly section 4553 was applicable to the conduct of Johns-Manville, and would thus constitute Rudkin's exclusive remedy regardless of whether that conduct was classified as "serious and willful" or "intentional" misconduct.

The court then found that an employee's allegation of fraudulent conduct by the employer could not form the sole basis of an action at law for damages.¹³ The primary reason such suits could not be maintained was that the workers' compensation system would be undermined.¹⁴ This was true even when grounds for the suit were not clearly traceable to the employment relationship. The court feared that "[t]he focus of the inquiry in a case involving work-related injury would often be not whether the injury arose out of and in the course of employment, but the knowledge of the employer and the employee regarding the dangerous condition which caused the injury."¹⁵

The court went on to hold that in certain exceptional circumstances the employer would not escape liability at law for intentional acts, even though workers' compensation covered the resultant employee injury.¹⁶ Although case law was by no means consistent, the court noted a common thread. In cases holding employers liable at common law, the employer's intentional misconduct had exceeded a failure to assure that the tools or materials used by the employee and the physical environment of the workplace were safe.¹⁷ Liability in an action at law was imposed for the misconduct which included physical assault,¹⁸ aggravation of a prior work-re-

13. The court at this point relied on the cases of *Buttner v. American Bell Telephone Co.*, 41 Cal. App. 2d 581, 107 P.2d 439 (1940), and *Wright v. FMC*, 81 Cal. App. 3d 777, 146 Cal. Rptr. 740 (1978). In *Buttner*, the employer suggested to the employee that certain dangerous chemicals used on the job were harmless. The injured employee's action at law for deceit was barred by the exclusive remedy in workers' compensation, the court finding that such benefits covered all injuries incurred in the course of employment, irrespective of the manner in which they might occur. In *Wright* a similar employee action was barred. The complaint had alleged fraud by the employer in concealing the risks involved in handling work materials.

14. 27 Cal. 3d at 474, 612 P.2d at 953, 165 Cal. Rptr. at 863.

15. *Id.*

16. *Id.* at 473, 612 P.2d at 953, 165 Cal. Rptr. at 863.

17. *Id.* at 475, 612 P.2d at 954, 165 Cal. Rptr. at 864.

18. *Magliulo v. Superior Court*, 47 Cal. App. 3d 760, 121 Cal. Rptr. 621 (1975). A waitress who had been assaulted by her employer was permitted to maintain an action at law, even though an application for workers' compensation benefits had also been filed. The court observed that under workers' compensation law an employee assaulted by a co-worker could recover damages at law as well as compensation bene-

lated injury,¹⁹ and fraudulent deprivation of a third party suit.²⁰ In such cases, the interest of society in deterring similar conduct was so great as to justify the imposition of punitive damages on the employer, and that penalty was available only in an action at law.²¹

In allowing Rudkin's action, the court perceived a trend toward permitting actions at law "if the employer acts deliberately for the purpose of injuring the employee or if the harm resulting from the intentional misconduct consists of aggravation of an initial work-related injury."²² The court, however, limited its holding to the latter situation. Only in those instances where suit was brought for aggravation of an existing work-related injury could an action at law be maintained. The court felt that such a narrow holding would prevent the opening of a "Pandora's box" of actions at law seeking recovery for industrial diseases.²³ The court believed that the exclusive remedy in workers' compensation would not be seriously undermined since most employers would not "aggravate the effects of an industrial injury by not only deliberately concealing its existence but also its connection with the employment."²⁴ Finally, the court found that double recovery by the employee could be avoided by allowing the employer a set-off in the event the plaintiff is awarded damages in his action at law.²⁵

fits. An employee assaulted by the employer had no such right. The court found this result to be inequitable; when an employer inflicts an intentional injury upon the employee, the courts are free to determine whether the employer loses his immunity from civil suit.

19. *Unruh v. Truck Insurance Exchange*, 7 Cal. 3d 616, 498 P.2d 1063, 102 Cal. Rptr. 815 (1972). An employee was permitted to maintain an action at law against her employer's workers' compensation insurer for assault, battery, and intentional infliction of emotional distress in connection with the insurer's investigation of her claim. The court noted that under California Labor Code section 3757 the insurer had "stepped into the shoes of the employer" for the purpose of bringing the claim to a final resolution. The court proceeded to hold that immunity from common law liability was lost when the insurer acted deceitfully in the course of the claim investigation.

20. *Ramey v. General Petroleum Corp.*, 173 Cal. App. 2d 386, 343 P.2d 787 (1959). The employer made misrepresentations and concealed the fact that the employee's injuries were caused by a third party against whom he had recourse. The court found the employee's cause of action to stem, not from the sustaining of the original injury, but from an occurrence that derived from that injury.

21. 27 Cal. 3d at 478, 612 P.2d at 956, 165 Cal. Rptr. at 866.

22. *Id.* at 476, 612 P.2d at 955, 165 Cal. Rptr. at 865.

23. *Id.* at 478, 612 P.2d at 956, 165 Cal. Rptr. at 866.

24. *Id.*

25. *Id.*

In cases alleging an intentional tort on the part of an employer, there has been particular pressure to circumvent the exclusive remedy rule of California Labor Code sections 3601 and 4553.²⁶ That punitive damages, as such, are unavailable under the workers' compensation law is one reason for this pressure.²⁷ Fairness is also a factor. An employee may expect workers' compensation to constitute the exclusive remedy for ordinary work-related injuries. It is less clear, however, that in accepting a job the employee would contemplate bargaining away his right to obtain a remedy at law in the event that his employer commits an intentional tort against him.²⁸ The court, in arriving at its decision to allow Rudkin's suit, took into account these considerations. It also afforded great weight to the policy of preserving intact the workers' compensation system.²⁹

As a matter of theory, this decision provides the best means of balancing these competing considerations. The decision allowed the court to resolve fairly the issue before it, while impinging as little as possible upon the territory of workers' compensation.

The court found Johns-Manville's misconduct to be particularly egregious. They refused to believe that "the Legislature in enacting the workers' compensation law intended to insulate such flagrant conduct from tort liability."³⁰ In the future, courts may find other flagrant employer acts that will not be afforded the insulation of workers' compensation.

As a practical matter, by allowing common law damage awards for the aggravation of a prior work-related injury, courts will be faced with a perplexing allocation problem. As workers' compensation benefits are still the exclusive remedy for an initial injury, an apportionment of the employee's disability between that injury and its subsequent aggravation will have to be made. That apportionment is certain to prove vexatious in cases where the employee alleges a cumulative

26. *Employer Liability for Intentional Torts*, 8 CAL. WORKERS' COMP. REP. 47 (1980).

27. As the court noted, the one-half increase in compensation benefits to the employee, as provided by § 4553, does not constitute exemplary damages. 27 Cal. 3d at 478 n.12, 612 P.2d at 956, 165 Cal. Rptr. at 866. In any event, such additional compensation is limited to \$10,000. CAL. LAB. CODE § 4553 (West Supp. 1980).

28. 27 Cal. 3d at 477, 612 P.2d at 955, 165 Cal. Rptr. at 865.

29. *Id.* at 474, 612 P.2d at 953, 165 Cal. Rptr. at 863.

30. *Id.* at 478, 612 P.2d at 956, 165 Cal. Rptr. at 866.

trauma type injury.³¹ When an injury does not manifest itself for several years it may be impossible to make the necessary distinction. In addition, through skillful pleading employees alleging cumulative trauma may be able to maintain civil suits. The determining factor in such suits may be the knowledge of the employer and the employee with respect to the dangerous condition which caused the injury, a situation the court wished to avoid by ruling as it did.³²

Justice Clark, joined by Justice Richardson, dissented fearing that the effect of the majority opinion would be a reduction in the number of employer-furnished medical programs designed to minimize industrial injury and disease; employers may try to remain ignorant of their employees' health problems in an effort to escape tort liability.³³ They further noted that any injury incurred by an employee as a result of a medical program provided by the employer was compensable under workers' compensation, and that Rudkin had not brought himself within any statutory exception.³⁴

The dissent, however, overlooked the fact that Rudkin was not directly injured by the medical program. Rather, that program was used by the employer as a vehicle to perpetrate its own fraud. The treatment rendered under the program was inadequate because Johns-Manville did not provide the physicians with sufficient information regarding the risks of asbestos exposure. Thus, the court's decision should have no significant effect on bona fide employer-furnished medical programs. Employers who act in good faith to try to minimize the occurrence of industrial disease need not fear that they will be held liable for damages in an action at law.

The court's holding, that an action at law may be maintained by an employee whose industrial disease is aggravated by the employer's fraudulent conduct, resolved the case at hand. Remaining unanswered, however, is the nebulous question of whether an employer who inflicts an initial injury may

31. "Cumulative trauma refers to the gradual onset of damage to some part of the body caused by repeated activities, either successive injuries to the same part of the body, or normal activities which alone are insufficient to cause disability but whose cumulative effect results in a condition causing disability." 1 S. HERLICK, CALIFORNIA WORKER'S COMPENSATION LAW HANDBOOK 364 (2d ed. 1978).

32. 27 Cal. 3d at 474, 612 P.2d at 953, 165 Cal. Rptr. at 863.

33. *Id.* at 480, 612 P.2d at 957, 165 Cal. Rptr. at 867.

34. *Id.* at 482-84, 612 P.2d 959-60, 165 Cal. Rptr. 868-70.

also be held at law.³⁵ The court neatly side stepped that issue by making a distinction between initial injury and subsequent aggravation.

The court did, however, provide some guidance toward the resolution of future cases. The exclusive remedy rule will continue to apply to employee injuries incurred in the course of employment. In exceptional cases where the public policy of deterring flagrant employer conduct is strong, and the total effect on the workers' compensation system is minimal, it can be expected that the courts will allow an employee action at law to be maintained.

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35. Two court of appeal decisions, *Azevedo v. Abel*, 264 Cal. App. 2d 451, 70 Cal. Rptr. 710 (1968), and *Magliulo v. Superior Court*, 47 Cal. App. 3d 760, 121 Cal. Rptr. 621 (1975), involve employees seeking to recover at law for initial injuries. Although the cases involved almost identical facts, they were resolved differently. *Azevedo* held that § 4553 barred an action at law, while the court in *Magliulo* permitted the civil suit. The supreme court explicitly stated that the initial injury issue was not presented in the case and was not resolved by the decision. 27 Cal. 3d at 477 n.11, 612 P.2d at 956 n.11, 165 Cal. Rptr. at 865 n.11.

